United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

75-6080

United States Court of Appeals

For the Second Circuit

Docket No. 75-6080

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

against

BERNARD JAY COVEN,

Defendant-Appellant.

B P/S

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANT-APPELLANT

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REPLY STATEMENT OF THE CASE AND ISSUES PRESENTED

The parties herein agreed, pursuant to Rule 30(c) Federal Rules of Appellate Procedure to file page-proof briefs and a deferred appendix. Since the filing of the briefs numerous additional cases have been decided relevant to the issues herein, and as to which the Court should be advised. In addition, Appellee's "Counterstatement of the Case' in its brief 1/ contains various misstatements of the record, some to the point of pure invention, and in other instances, in obvious preparation for its argument, has set forth a melange of irrelevant matters seeking to create a prejudicial atmosphere, which quickly is dissipated in the light of the facts. Also, as a consequence the Appellee larded the Joint Appendix, printed at the expense of the appellant, with both unnecessary Exhibits and transcript pages.

1/ Reference to the Brief of Appellee will be to "Br._" Reference to the Appellant's Main Brief will be "App.Br._" Appellee's Counterstatement of the Case is at Br. 2.

Dennison Personnel, Inc. and
Gerald Bowes, its President

Dennison Personnel, Inc. ("Dennison") maintained an office in the New York financial district at 32 Broadway, New York, New York. Its office was across the street from the office of the co-underwriter, Stevens, Jackson, Seggos (which also had an office at 211 W. 43 Street, New York City, in addition to its office at 11 Broadway, New York City 759a, 789a). Among the business of Dennison it placed registered representatives in brokerage houses and "investment banking firms" (731a). Dennison had on its Board of Directors persons with specialized knowledge of the securities industry and of underwritings, all of whom were required as directors to sign the registration statement. These persons included Albert Watt associated 40 years with the member firm of De Coppet and Doremus; John H. Kirvin of the member firm of John Kirvin & Co., Inc., who had also served as vice president to the New York Stock Exchange and was also an officer of the member firm of Glore Forgan, Wm R. Staats, Inc. and was then Chairman of National-Over-The-Counter Clearing Corporation (735a). Bowes, the president,also had practical experience in an underwriting,having gone through a complete registration statement and filing in 1970 with Robert Cea & Company, Inc. as underwriter (680a), the underwriting having been aborted because of the subsequent insolvency of the underwriter. The said underwriting was on an all or none basis (680a).

When Bowes retained Coven formally on June 30th, 1971,

he was retained as both special counsel for the proposed issue as well as general counsel for the company. Accordingly, two retainer agreements were signed, one with respect to the issue (821a) and one of general yearly retainer (750a). The underwriting contemplated at the time and subsequently indicated by the filed registration statement was a straight best efforts (683a), the underwriter was to use its best efforts to sell up to 150,000 shares at $5.00 per share. No minimum number of shares was fixed. In view of the fact that there was no assurance as to the number of shares which would be sold, the retainer agreement reflected this in the fixing of compensation. Compensation was adjusted to number of shares sold. Thereafter, when it appeared that the Company required a minimum sum to achieve any of its objectives and to remain viable the issue was changed to a minimum-maximum issue, the price reduced and the number of shares offered increased. The total issue was also reduced from $750,000 to $600,000 (688a). This necessitated an amended retainer agreement. This second agreement was executed on April 13, 1972 (756a). Coven had an interest in having more than the minimum number of shares sold as the AMENDED agreement provided that in the event that the Issuer Dennison received at least $100,000 over the minimum Coven would be entitled to an additional $5,000. (757a). Bowes' testimony that he did not know why the retainer agreement was revised (134a) was incredible. From time to time Bowes took refuge in his testimony, particularly on cross, that Coven told him to sign papers and not to read them, and thus not having read

them he relieved himself from testimony concerning their contents. The Commission seeks to make some capital out of this in explaining away the strange conduct of Bowes (Br.5 n.7). Bowes put himself into knots in attempting to maintain this position, and his testimony was patently evasive 2/. The Appellee, however, was not satisfied to merely quote the transcript but states that Bowes testified that he probably signed the document in blank (Br. 19 n.32 cont'd). This embroidery is not found in the testimony 3/.

The appellee seeks to bolster a sagging suggestion that in some manner Coven was not loyal to his client, the issuer. The appellee states that late in June Coven informed Bowes that the issue had to be deregistered but didn't tell

2/ Bowes on cross was asked whether he ever read the underwriting agreement between Dennison and the Seggos firm (178a). He replied "yes, sir". When he was later asked what else did he recall about the agreement (179a) he took refuge in the response that he signed it and "forgot about reading it" in accordance, he asserted with Coven's instructions, even though he "didn't want to" (179a-180a).

Bowes also took refuge with this response when faced with obvious contradictions of various dates given in his testimony. Bowes testified that it was late in July or early August that he first learned that the stock of Dennison was being publicly traded (169a-170a). On July 17th, 1972 Bowes, on behalf of Dennison, executed a post effective amendment which deregistered the remaining unsold shares. This amendment was filed on July 18th, 1972. On cross Bowes admitted that he executed the document after he knew that the stock was trading (183a, 184a, 187a-189a).

Bowes reached the reductio ad absurdum when he was asked about an underwriting agreement he had signed with Lehman, Bartel & Co. "Were you allowed to read Exhibit 4? A. I don't know if I was allowed to read it or not. Q. You did sign it though? A. That doesn't mean I was allowed to read it."

3/ The balance of note 32 is likewise an invention of the Appellee. The note reads that Bowes testified that he did not learn that the maximum had not been sold until informed by Rega at a meeting at Coven's office at which Coven was not present. There was no testimony at the trial whatsoever that

him that the selling had stopped (Br.17 n.30). Assuming this, arguendo, Bowes knew that when trading commenced the issue was closed (176a) and, putting aside for the moment Bowes' previous experience with an aborted issue, the knowledgeable members of his board of directors, it is a severe strain to believe that Bowes did not understand that deregistration of 2,926,500 shares meant that these shares could no longer be offered.

The contentions of the appellee that Bowes was kept in ignorance of the progress of the issue is belied by the testimony. Ziffer, the person in charge of the sales for Seggos firm was in daily touch with Bowes. In fact, Ziffer visited Bowes' office almost every day and discussed the progress of the issue with him (156a). Bowes also frequently called Rega of Carlton Cambridge and discussed with him also the progress of the issue (150a, 153a) 4/.

Bowes was attempting to put pressure on Coven to close the issue (352a). When Coven spoke to Bowes about a closing which was to be held the following day, June 12, 1972, Bowes told Coven that if the closing was not concluded the issuer would go bankrupt (352a, 365a). Coven replied that in view of that statement he intended to co-sign checks of the issuer

3/ (continued) Bowes ever met Rega at Coven's office. Bowes testified that he called Rega and Rega informed him that he would meet at Bowes' office (171a). Bowes met with Rega at Bowes' office (172a). He was specifically asked again on direct, "Where did this meeting take place? A. Dennison Personnel" (171a).

4/ Both Ziffer and Rega told Bowes that the issue would be fully sold in that each house would take and sell one half of the issue (138a, 139a).

to safeguard the public, assuming that the financial statements at the closing were satisfactorily explained by the accountant for Dennison. It was based upon this phone call that Bowes appeared at the bank on June 12 with his personal attorney, Greco. Bowes testified about the efforts of Coven to so safeguard the funds (149a) and that he "verbally abused" Coven (150a). After this event the mind of Mr. Bowes went conveniently blank about anything else that went on at the June 12th meeting (150a).

Dennison was not a party to the action here. All witnesses were excluded with the exception of Greco whom the Court permitted to remain in attendance while Bowes testified (148a). Greco knew he was to be called as a witness for the plaintiff (148a). Greco testified that Bowes called him two or three weeks after the closing of June 12 to tell him that a market in the stock had opened (362a). This would be the 29th of June or the first week of July. This testimony makes consistent several pieces of both testimony and exhibits and highlights the glaring inconsistencies of Bowes. As will be indicated the appellee's contention that Bowes did not learn until late in July that the issue was concluded and that he called Coven who claimed ignorance (Br.17) makes no sense. It also sets straight the improper inferences made by the appellee with respect to the inconsistencies of Bowes' testimony (Br.18 n.32). Coven first learned that Carlton Cambrige had gone into the pink sheets on June 29th, 1972 (343a). The first week of July included a weekend and a national holiday. On July 7th, 1972

Coven called the Commission in Washington and discussed the situation raised by this trading and informed Bowes' office that he had communicated with the Commission and that deregistration was necessary (172a, 173a). That Coven called the Commission on July 7th was conceded by the plaintiff (42a ¶71). Instead of executing the degistration statement Bowes on his own (162a-165a), without informing Coven, started independent discussions with Carlton Cambrige, held a meeting at his office with Rega and Gamerikian of Carlton Cambrige and obtained two exhibits, a letter from Carlton Cambrige dated July 11th (765a) and an undated stipulation (764a). What Bowes and Carlton were planning with these documents was never established. The explanation given by Bowes that he wanted to make sure that the issue was going to be extended is incredible (165a) in view of the facts ab ove recited. Bowes said that Rega told him that Carlton Cambrige proposed "to do a secondary," explaining the term to the trial judge "A secondary of the remainder" (173a), a use of a highly technical term by a witness who sought to give the impression of abysmal ignorance of securities. He kept these papers secret even from Greco, his then attorney 5/. Bowes testified that about this time it was the policy of Dennison to "disengage Mr. Coven" (175a).

5/ It will be recalled that this was not the first time that Mr. Bowes acted in a unilateral manner without consulting Mr. Coven. On June 21, 1972 Bowes wrote a letter to the American Stock Transfer Company authorizing them to issue 3,073,500 shares (159a, 160a, 763a). Without this authorization the shares could not have been distributed. (Opp. Br. 7)

Greco, Attending the
June 12th Gathering

The appellee gives only a slanted portion of the performance of Greco at the June 12th meeting (Br. 12). Greco conceded that "in fairness" there was a disagreement among the three attorneys present as to the interpretation of the law (355a) and there was a difference of opinion with respect to the documents (358a). When asked whether he told Bowes to leave the June 12th meeting, the witness took his client-attorney privilege (365a). This was permitted notwithstanding the comment by the Court to the effect that as he, the judge, understood it, the privilege had been waived (348a).

The Closing in Escrow

The appellee's brief (Br.14) misstates the testimony of Coven to the effect that the important factor to Coven was that the Issuer's share of the proceeds be on deposit with the escrow agent. Coven indicated that there were many factors present which led him to believe that the minimum number of shares had been sold (624a-626a). The appellee in its brief apparently concedes that the minimum was sold but is now contending that all were not bona fide purchasers (Br.15). This is taken on the erroneous assumption that shares issued in street name could not have been sold to bona fide purchasers.

Appellee takes the position that Coven in accounting for 3,075,000 shares assumed that the minimum of 3,000,000 shares were sold and simply added an additional 75,000 shares to account for a check of Seggos produced on June 12th. The Court took a similar position (Op. II 105a). In the first

instance it was not a check of Seggos. It was a deposit consisting of several items (785a). One of these items was $2,756.25 which obviously was not a gross check in view of the fact that the offer was at ten cents per share. Seggos was remitting to the bank a check of a member of its syndicate, Gotham securities, who had already deducted their commission (785a). To conclude that Coven simply added 75,000 shares to his totals from this deposit is hardly logical. The letter of Coven to the Bank of June 13, 1972 (791a) indicated that there had been a commission deduction with reference to the funds submitted through the Seggos firm. It also may be noted in connection with the letter that it advised the Bank that the Transfer Agent had already been directed as to the number of shares to be issued. The appellee in its calculations misstates the amount of the check brought by Carlton Cambrige to the closing as $31,494 (Br.12). The check was for $31,503.75 (793a). When it was remitted by collection of the Bank there was a bank charge of $10. As a result of this charge 100 shares were not accounted for and partly contributed to the discrepancy between 3,075,000 shares and 3,073,500 shares. This bank charge was not disclosed in the Bank's accounting of funds. It was made on June 20, 1972.

To continue to chase down further miscitations of the record would result in an over-length brief. A few further matters should be mentioned.

The appellee cites to the Manor Nursing case (Br.6 n.11 - Br. 7) and infers therein that Coven having been an

attorney in that case representing the "principal" of Carlton Cambrige, Netelkos, attempting thus to lend support to a previous appellee assertion that Coven had some special connection with Carlton Cambrige. First, Netelkos was not then a principal of Carlton; second, the president of Carlton was a witness against Netelkos, and lastly, this irrelevancy is an improper attempt to prejudice the appellant.

In like vein, appellee wrongly states that Coven was a "business associate" of Lehman, Bartel principals. A statement nowhere finding support in the record. (Br. 5 n.8).

E. P. Seggos, president of the co-underwriter, testified for the plaintiff. His testimony was palpably evasive and properly disregarded by the Court in its entirety. Appellee resurrects a portion of the discredited testimony to conclude that the initial arrangement in the Dennison offering was that Seggos' firm act as an accommodation underwriter (Br. 6 n.10).

For some reason the Court swallowing whole a proposed Commission finding stated that Coven while purportedly angry with Rega worked as counsel for another issuer on a new underwriting with Carlton (Op.II 116a-117a, Br.18,24) The fact is, however, that this second issue was some six months later and at a time after Rega had left the firm (647a, 648a, 650a). This second issue was December 29, 1972.

The brief of the appellee contains other gross misstatements of the record, which should be mentioned in brief fashion. The appellee states that Coven had been telling Bowes that the minimum of 3,000,000 shares had been sold and had been saying the same things to Ziffer of Stevens Jackson

(Br, 11 and n.18). An examination of the transcript cited is barren of any such testimony. Coven told Bowes that "the issue was going along fine" (153a) and told Ziffer that "when three million shares were sold there would be a closing" (426a). Again, at Br. 10 the appellee states that on June 2 the Bank was provided with a copy of Coven's opinion of counsel dated May 30, 1972 which indicated that a closing could be held. The undisputed fact agreed to by the parties to the action is that the letter was delivered "on or before June 12, 1972" (38a ¶38; 285a-286a). Ackerman, an attorney testified that the letter had been prepared for a May 30th closing, which did not take place, brought the letter to the June 12th gathering at the bank and neglected to change the date (451a,452a).

In appellee's Br. 18 there appears a grossly inaccurate statement that during the issue Coven appeared as counsel for Stevens Jackson in a merger negotiation. It appeared that Stevens Jackson had stopped trading because its books were not up to date and it could not produce an immediate balance sheet as required for the National Association of Securities Dealers (313a). Coven, at his own expense of $1,000 had an accountant go to Stevens Jackson and examine their financial condition 6/ (573a,574a). Coven attempted to arrange a merger between the

6/ If Stevens Jackson was out of required capital ratio the Dennison issue could not have continued. Subsequently, the books and records were brought up to date and the firm's condition was found in order and not impaired (313a-314a)

the two underwriters[7] which almost immediately fell through. (243a-246a). In these matters Coven was attempting to assure the success of the underwriting and was acting in the interests of his client, the issuer. (591a) On June 14, 1972, two days after the gathering at the Bank and seven (7) days before the escrow funds were distributed by the bank, Seggos, of Stevens Jackson appeared at the Securities and Exchange Commission and testified in an investigative hearing regarding the financial condition of Stevens Jackson. (42a ¶73). The Commission was informed of the status of the underwriting and funds. Glusband, of the Commission had already noted the JUNE 5TH appearance of M.S. Wien in the sheets (221a, 222a) and had concluded that such market activity was not improper. (221a-222a).

The appellee's brief Br. 10 n.15, notes that Gotham Securities, a member of the Stevens Jackson selling group, continued to sell the new issue until June 20. Assuming, this, arguendo, omitted is the fact that these shares were cancelled, and further, Gotham Securities, had access to the sheets of the National Quotation Bureau, which sheets indicated that the underwriter, Carlton Cambrige had commenced trading publicly on June 16, 1972 and hence no further shares could be sold. (222a)

Glusband of the Commission

As indicated above Glusband, an investigator for the Commission, who had conducted the due diligence meeting with respect to the issue preceding its effective date (217a) noted the appearance of M.S. Wien in the quotation sheets and saw nothing improper in its appearance. In late June of 1972

7/ Such a merger if consummated would have had to have the approval of the Commission.

he checked the market makers in the Dennison issue (219a) and saw nothing improper(221a-222a). He noted the appearance of Carlton Cambrige in the quotation sheets on June 16 and saw nothing improper in that appearance (222a). At the end of June 1972 he began an investigation of the issue, sending out questionnaires. It was agreed by the parties to this action as an undisputed fact that on June 29, 1972 Coven called Glusband"and inquired of Glusband as to the nature of the investigation and which violations, if any, were being alleged." (42a ¶70). It may also be noted that prior to this call by Coven, Glusband had already spoken to M.S. Wien (415a). Mr. Coven told Glusband that he and Bowes would immediately come down to Glusband's office, hear any complaints and "provide any explanation that he required" (525a). Mr. Glusband refused to provide any information or to confer (526a)8/.

Aside from the fact that the issue was legally terminated by the entry of the underwriter Carlton Cambrige in quotation sheets on June 15th, 1972, a fact which Coven learned on June 29th, 1972, this investigation by Glusband, the nature of which the Commission withheld would effectively prevent further closing of any portion of the maximum part of the issue. This arises from the fact that Coven as attorney for the Issuer would have been required to furnish an opinion in accordance with the underwriting agreement in the form set out at 759a-762a. The opinion requires disclosure of investigations and their nature (760a ¶(h)).

8/ Glusband took the position that the investigation was a "private investigation" and therefore he could not give any information to anyone as to what it was about (417a)

Duties of the Attorney for the Issuer

The duties of an attorney for an issuer properly encompass the seeking of an underwriter for his client; the obtaining of a transfer agent' s services and the execution of the agreement between the issuer and such agent; the obtaining of an escrow agent and the negotiation of such agent's agreement and of the fees to be paid by the issuer; and the drafting of the registration statement, subject to review by the attorney for the underwriter. The brief of the appellee echoes a statement of the Court below that since Coven "provided the impetus for the launching of the issue" it follows that Coven is responsible for all of the ills which befall distribution (Br.23). Such an extended scope is impractical and unreasonable. The brief makes play of the in-house manipulation of Carlton Cambrige by sales to and purchases from its own customers. Such in-house trading prior to even the closing of the minimum on June 12th, 1972 is impossible to detect by any private attorney for the issuer. Indeed, as Glusband testified a formal investigation was not commenced until the Commission had sent out and had returned hundreds of questionnaires, a scope of inquiry obviously beyond the ability of the issuer's attorney. Again, that the selling tactics of Carlton Cambrige's salesmen were "riddled with irregularities" (Br.9) is hardly a fact that can be determined by the issuer's attorney without a team of detectives. In the brief of appellee there appears the following statement (Br.20)

> "The district Court also found that Rega deliberately and secretly stopped his firm's sales efforts on May 29, 1972..." (Emphasis Supplied).

When this is considered, with the additional undisputed facts, that three days after the gathering at the bank, Carlton was, on June 16, to publicly commence trading in the National Quotation Sheets, without prior notice of intention to do so and that the minimum portion of the issue was not to close until June 21, when the bank distributed the funds and stock certificates, the absurdity of holding Coven as an aider and abettor to Carlton's failure to use its best efforts to sell the maximum portion of the issue is readily apparent . The entry by Carlton into the National Quotation Sheets was in effect an official announcement that the new issue had terminated 9/.

Carlton did not even pause to give the required notice of termination of the issue contained in ¶7(b) of the Underwriting Agreement (794a).

9/ Continued distribution by an underwriter who had commenced trading the issue would be a glaring violation of Rule 10b-6 of the Securities Exchange Act.

The appellee notes that Gotham Securities, a member of the Stevens Jackson selling group continued to sell the new issue until June 20. As a broker dealer Gotham was serviced by the National Quotation Bureau's National Quotation Sheets ("Pink Sheets") and was obviously on notice that trading by an underwriter in the issue had commenced on June 16 and that, therefore, no further distribution of the new issue was possible. As a member of a selling group Gotham had to receive stock for its customers from an underwriter. (Br.10 n.15)

It should be noted that in order for Carlton to appear in the Quotation Sheets for the morning of June 16 its quote request to the Bureau had to be delivered not later than June 15, the day before.

Carlton's check left with the bank for collection on June 12 was not paid until June 20 (793a) and as indicated above the minimum closing did not take place until June 21. The commencement of trading by Carlton on June 15th, the quotation appearing on June 16, was not to be anticipated. The Court below did not comprehend that if Carlton had an obligation to continue to sell the maximum portion of the issue using "best efforts" it could not be compelled to do so, certainly not past June 15. The appellee urges that Coven aided and abetted such violation, echoing the Court and relying upon such nebulous and unconnected phraseology as "indifferent attitude" and "disinterest" and "unacceptable for the drafter of the underwriting agreement". The Court states that Coven should have made inquiry of Rega "with respect to the maxi portion of the underwriting" (110a). Assuming such obligation, arguendo, if Rega truthfully responded that the issue was terminated it is difficult to see how Coven could aid and abet him in the failure to use "best efforts". There is no way to compel an underwriter to use its "best efforts" to sell more shares or to prevent termination.10/ This, of course overlooks completely that the issue was in fact already terminated secretly by Carlton when it secretly stopped selling the new issue and immediately commenced trading in-house with its own customers. Indeed, Carlton was compelled by such conduct to commence public trading as fast as possible11/.

10/The underwriting agreement contained the boiler plate "market out" clause which in effect gives the underwriter untrammeled discretion to terminate the issue ¶7(b) (794a). It also may be noted that the within action is the first in which the Commission has contended that the underwriter's failure to use "best efforts" was violative of the securities acts.

11/See Note 9, supra.

ARGUMENT

1. COVEN DID NOT AID AND ABET THE VIOLATIONS OF REGA AND CARLTON CAMBRIGE AND, IN ANY EVENT THE COURT APPLIED ERRONEOUS STANDARDS IN THE DETERMINATION

As set forth previously in this brief and in the main brief of the appellant, Coven did not aid and abet the alleged violations of Rega and Carlton Cambrige. It is also urged that in any event the lower Court applied an erroneous standard in the determination.

The Injunction Appealed From

In seeking to overcome the effect of Hochfelder the appellee seeks to improperly inject Section 17(a) of the Securities Act stating that the Commisssions "allegations" against Coven were "premised"on both Rule 10b-5 and Section 17(a), seeking in this manner refuge in Securities and Exchange Commission v World Radio Mission (Cir. 1st 1976), 544 F. 2d 535. In the first instance the injunction against Coven plainly tracks the language of 10b-5(3) (43a-44a ¶II) 10b-6 (45a-47a ¶IV) and 10b-9 (47a-48a ¶V). In Securities and Exchange Commission v Cenco, Inc., Fed. Sec. L. Rep. ¶96,133 (N.D.Ill. July 1977) the"allegations" against the defendants were "premised" upon alleged violations of Rule 10b-5 and Section 17(a) (note 1 at p. 92,096). In determining whether an injunction should issue the Court felt required to analyze the determination in terms of Hochfelder's requirement of scienter, although enlarging the definition by including a species of recklessness akin to intent. The Court concluded that scienter, as so expanded should be applied to injunctive

actions instituted by the SEC (p.92,100). In Securities and Exchange Commission v American Realty Trust, 429 F. Supp. 1128, 1171 (E.D. Va 1977) the Court held scienter to be a necessary element in an injunctive action brought by the Commission alleging violations of Section 17(a). In both Cenco and American Realty Trust the Court declined to follow World Radio Mission. Assuming arguendo, that in some manner that portion of the injunction appealed from herein (43a-44a ¶II) can be said to import Section 17(a)(3), the Court in Sanders v John Nuveen & Co., Inc. (Cir 7th 1977), 554 F. 2d 790 (1977) specifically held that "Proof of scienter is unquestionably required" as to subsection (3) of Section 17(a) (p.795). In that case the Securities and Exchange Commission filed a brief as Amicus Curiae (p.794 n.6). The Court concluded that in the light of Hochfelder an action under Section 17(a) cannot be premised upon negligent wrongdoing and"in the absence of scienter judgment for plaintiff cannot be sustained under §17(a)" (p.796).

In Securities and Exchange Commission v Lummis. Sec. F. L. Rep. ¶96,245 (N.D. Cal. 1977) the defendant was cited with alleged violations of Rule 10b and Section 17(a). The Commission, citing World Radio Mission, argued that an injunction is obtainable without proof of scienter. The Court noted that such a proposed rule "must presume that the action to be enjoined is itself, without regard to the defendant's state of mind, a violation of the securities laws" (p.92,638 n.3). In Securities Exchange Commission v Universal Major Industries (Cir. 2d 1976), 546 F. 2d 1044, cited by

appellee, the violation there charged of Section 5 of the Securities Act did not require proof of intent to violate.12/

Aiding and Abetting Criteria

Although the Court in Hochfelder never reached the issue of aiding and abetting, a close examination of its opinion indicates that it, in fact, resolved the issue, certainly with respect to the necessity of proof of scienter. The opinion considered Ernst & Ernst as a principal. It would appear logical that the imposition of liability applicable to a principal should be lower than the threshhold applicable to one who is sought to be HELD secondarily liable. The Court indicated moreover in Note 7 of its opinion (47 L. Ed. 2d p.676) that some form of scienter would be required, citing favorably various cases favoring that point of view 13/.

12/ In addition, this Court noted that the District Court had made a finding that the appellant acted "with knowledge or reckless disregard of the truth" P.1047 n.1. Such a finding is absent in the instant case.

13/ The Court's citations were preceded by the signal "See" This signal is employed when "cited authority constitutes basic source material supporting an opinion or conclusion of either fact or law drawn in a textual statement. It indicates that the asserted opinion or conclusion will be suggested by an examination of the cited authority rather than that the opinion or conclusion is stated by the cited authority" A Uniform System of Citation, 11 ed. p.87 (pub. Harvard Law Review Association).

This is to be compared with the signal employed by the Court in Note 12 (p.677) of "Cf" with reference to the citation of SEC v Capital Gains Research Bureau, Inc. "Cf" cites are used when: "Cited authority supports a statement, opinion or conclusion different from that in the text but sufficiently analogous to lend support to the text" A Uniform System of Citations 11ed p.87.

The appellee sees signficance in the fact that the Hochfelder Court cited Capital Gains (Br. 44). The citation can hardly be given the meaning ascribed by the Commission, (See note 13 supra). The case was cited to indicate what the law was rather than what it would be if the issue were before the Supreme Court.

In Rondeau v Mosinee Paper Corp, 422 U.S.49, 45 L.Ed. 2d 12, 95 S. Ct. 2069 (1976), the Court, in an action for injunctive relief under the Williams Act, 15 USC §78m(d), rejected a mere negligence standard and recognized that in a suit for violation of the securities laws "inadvertence" is not a basis for the harsh remedy of an injunction.

It is submitted that Coven cannot be held liable as an aider and abettor because there was absent any proof that his alleged inaction was consciously intended to aid the alleged securities law violation. Rochez Brothers, Inc. v v Rhoades (Cir 3rd 1975), 527F. 2d 880; 889, SEC v Coffey (Cir. 6th 1974), 493 F. 2d 1304,1317; Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution 120 U. Pa. L. Rev. 597, 620-645 (1972); nor was there any proof that his alleged inaction provided substantial assistance to Rega or Carlton with respect to their failure to use "best efforts" and their 10b-6 violation. As demonstrated previously in this brief Coven cannot be said to aided and abetted violations which had already occurred, as to which he was without knowledge, which he could not prevented, and indeed which were beyond his responsibilities as attorney for the issuer.

Faturik v Woodmere Securities, Inc., Fed. Sec. L. Rep. 1977) ¶96,063 (SDNY) held that "the one clear requirement for establishing aider-abettor liability under §10b is actual knowledge of the fraud." In Halcyon Securities, Inc. v Chase Manhattan Bank, Fed.Sec. L. Rep. ¶96,212 (SDNY 1977) and again in Steinberg v Carey, Fed. Sec. L. Rep. ¶96,215 (SDNY 1977) the Courts held that knowing assistance or participation in the alleged fraud was required to establish aider-abettor liability. None of these factors are present in the instant case.14/

Recklessness akin to Scienter

The appellee seeking to satisfy Hochfelder requirements characterizes the conduct of Coven as "reckless". Such labeling, of course, does not make it so. The Court below did not make such finding. In Hochfelder Ernst & Ernst were charged with "inexcusable negligence", the Court held that such was not the equivalent of scienter, the intent to deceive or to defraud. In Sanders v John Nuveen & Co., Inc.,

14/ The Court below specifically held that knowledge that a violation is being committed and intent to further the illegal act was not required to be proved to assert aider-abettor liability Fed. Sec. L. Rep. ¶95,222 at p.98,146, applying a negligence standard. No finding was made below on what Coven's duties were other than the pervasive repetition to the effect that he was to be a one man police force on every aspect of the issue without regard to the duties of the underwriters and their counsel. Coven, as the Court intimates, could never rest for a moment or ever assume that attorneys or brokers were obeying the law or fulfilling their obligations. ~~The trial~~ Judge CARTER was later to hold in Hirsch v DuPont, 396 F. Supp.1214 (SDNY 1975) that inaction can never, absent an independent duty, give rise to liability as an aider-abettor, providing there is knowledge of the fraud and substantial assistance is provided . Hirsch v duPont (Cir. 2d1977) 553 F. 2d 750,759.

cited supra,[15] the Court of the Seventh Circuit held that in in view of the analyses in Hochfelder

> "[T]he definition of 'reckless behavior should not be a liberal one lest any discernable distinction between "scienter" and "negligence" be obliterated for these purposes. We believe "reckless" in these circumstances comes closer to a lesser form of intent than merely a greater degree of ordinary negligence. We perceive it to be not just a difference in degree, but also in kind." (p.793)

While there can be no litmus paper test of what constitutes "reckless" it must be such conduct as to be the equivalent of knowledge, closely approaching that which attaches to conscious deception. The Court in Sanders adopts the view of Franks v Midwestern Oklahoma Development Authority, (Fed. Sec. L. Rep. ¶85,786) that in the context of omissions "recklessness" is defined as "highly unreasonable" "involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care" and which "presents a danger of misleading...that is either known or so obvious that the defendant must have been aware of it." (at p.793). Judge Weinfeld in Steinberg v Carey, cited supra, in lengthy footnotes examines the definitions of "reckless", all of which are closely akin to scienter.

As indicated in the first portion of this reply brief and in the main brief, the issuer, Dennison, received funds for the purchase of 3,073,500 shares, 73,500 shares more than the minimum. The appellee realizing the weakness of its case argues that the shares were not sold in "bona fide transactions" (Br.27) referring to new issue distribution by Carlton Cambrige.

15/ The SEC appeared as Amicus Curiae in the case

If the minimum number of shares required to be sold were not sold the issue was not effective (724a), and no shares could be sold. If therefore, as the Court contends, the minimum number were not sold then Coven patently cannot be held as an aider and abettor of Carlton's failure to sell the maxi portion of the issue. Appellee seeks to straddle by arguing, in effect, that the minimum had been reached but not in bona fide transactions. This conclusion with reference to bona fide transactions was based upon attenuated inferences. However, if, in fact, Carlton's sales of the new issue were not bona fide, e.g. to non-existent customers, Coven had no way of knowing 16/. Further, once Carlton commenced trading in-house with its customers on June 2d Carlton could not resume distribution of the new issue as that would result in flagrant violations of Rule 10b-6, as Carlton could not both trade and participate in distri bution of the new issue 17/. It is Hornbook law that one cannot aid and abet the commission of an act which has already occurred. To urge that Coven aided and abetted the failure of Carlton to use its"best efforts" with respect to the maxi portion of the issue and to further charactrize Coven as "reckless" is patently absurd.

16/ The Commission after a year of investigation, using all of its broad powers of subpoena was never able to conclusively determine that the sales of new issue shares by Carlton was not bona fide.

17/ The"distribution" mentioned here is with reference to the sale of the new issue. It should not be confused with the "distribution" of Carlton in its massive trading with its own customers. The Commission does not contend that Coven aided and abetted this latter 10b-6 violation of Carlton.

With respect to the entry of M.S. Wien into the National Quotation Sheets appellant treats this question in his Main Brief pp. 19-25. The brief of the appellee urges that the gist of Rega's 10b-6 violation was that he improperly induced Wien to go into the sheets by telling the trader that the issue had closed (Br.37). The JUNE 5TH appearance of Wien was normal and legal and not a red flag. The appellee seeks to support an argument as would hold Coven as an aider and abettor for failing to make inquiry after the violation had already occurred. Wien's appearance might have been a red flag if two further facts were known (a) that Rega had terminated the issue and (b) that he was trading the stock in-house with his own customers. Neither of these facts were known and could not have been known. Further, as noted by the appellee (Br.39-40) Carlton was under obligation to give notice to Dennison by telegram that Carlton's participation in the underwriting had terminated. No notice was ever given.

II THE COURT BELOW EMPLOYED AN ERRONEOUS STANDARD IN DETERMINING WHETHER AN INJUNCTION SHOULD ISSUE AGAINST COVEN

The determination of whether an injunction should have issued against the defendant Coven should have been determined in accordance with the Hochfelder criteria S.E.C. v Cenco, Inc., Sec. L. Rep.¶96,133 (N.D. Ill. 1977) at p.92,100. The Court cites to SEC v American Realty Trust, cited supra and declines to follow World Radio Mission, and extends its ruling to Section 17(a) of the Securities Act. The INSTANT lower Court's determination of whether there was a liklihood that

the wrong would be repeated was couched on a negligence premise. It is noted that, in any event, the Court applied an unfair burden upon the defendant Coven. In Securities Exchange Commission v Bausch & Lomb, Inc. Fed. Sec. L. Rep. ¶96,186 (Cir. 2d 1977) this Court stated the requirement, as "well settled" that the Commission "cannot obtain relief without positive proof of a reasonable liklihood that past wrong doings will recur" at p.92,353. (EMPHASIS SUPPLIED) This Court also noted in the cited case that illegal activity without more does not justify the issuance of an injunction. In the instant case the Court below after finding that past conduct to be per se suggestive of the liklihood of future violations unfairly placed the burden on defendant Coven to provide the Court "some basis for believing that...illegal activities will not be repeated." (¶95,222 at p.98,149). Other than seeking to prove a violation the Commission offered no proof that there existed a cognizable danger of recurrent violation, Bausch & Lomb, cited supra at p.92,353-3; American Realty Trust, cited supra, at p. 1176.

Further, the Court failed to take into consideration the totality of circumstances. Coven has been a securities attorney for over twenty years and was never previously charged with a securities law violation. The injunctive relief was granted three years after the alleged events (See, SEC v Koracorp Industries, Inc. Sec. L. Rep.¶95,532 [1975-176 Transfer Binder] (N.D. Cal.1976) injunction denied where no violations within the preceding 18 months). The

Commission sought no restraining order and never halted trading in the Dennison issue. It began its investigation in 1972 and did not move to trial until almost two years later. Coven's conduct cannot be characterized as wilfull or reckless and the circumstances were isolated and not likely to recur. It also may be noted again, that this action is the first occasion where the Commission has sought relief for an alleged failure of an underwriter to exercise its "best efforts", alleging it to be violative of the securities laws. With respect to the escrow account counsel for the Commission conceded that the law was open to question (662a, 663a). The Commission terms an injunction "a mild prophylactic,"but as stated by the Court in Cenco, cited supra, "We agree that no injunction should be lighly issued for the ramifications are very serious" at p. 92,099.

In Arthur Lipper Corp. v Securities and Exchange Commission (Cir 2d 1976), 547 F. 2d. 171 this Court assumed that Hochfelder scienter standard applies to SEC administrative proceedings. In Buchman v Securities and Exchange Commission this Court again applied the Hochfelder standard to disciplinary proceedings (553 F. 2d 816). In Collins Security Corporation v Securities and Exchange Commission (D.C. Cir.1977) Fed. Sec. L. Rep. ¶96, 122 the Court required a standard of proof in disciplinary proceedings involving fraud charges of "clear and convincing evidence". Rule 2(e) of the Commission's Rules of Practice, 17CFR 201.2(e) provides for ex parte suspension from practice of an attorney suffering an injunction and in any subsequent hearing places the burden

upon the attorney to show cause why he should not disqualified from practice and provides that in any such hearing he shall not be permitted to contest the findings made against him in the judicial proceedings. If this Court finds that negligence is sufficient to sustain an injunction (which conduct is disputed by the appellant) then the appellant may well be deprived of his livelihood without the ability to compel the Commission to prove his culpability by Hochfelder standards and by clear and convicning evidence. In Collins the Court of Appeals disregarded forty years of Commission rhetoric regarding the proof required in administrative disciplinary proceedings where deprivation of a livelihood was at stake. It is likewise respectfully submitted that this Court consider the awesome consequences to a securities attorney deprived of his livelihood and standing by injunction. This should be heavily weighed in the "totality of circumstances", see SEC v American Realty Trust, cited supra at p. 1176; and SEC v Broadwall Securities, Inc. 240 F. Supp. 962,967 (SDNY1965); SEC v Harwyn Industries, Corp., 326 F. Supp. 943 (SDNY 1971)

CONCLUSION

For the foregoing reasons the judgment of permanent injunction should be reversed.

Respectfully submitted,

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Srcurities and Exchange Commission,
Plaintiff-Appellee,

against

Bernard Jay Coven,
Defendant-Appellant.

STATE OF NEW YORK
CITY OF NEW YORK } ss.:
COUNTY OF NEW YORK

Elliot Guzman, being duly sworn, deposes and says, that he is over 18 years of age. That on the 29th day of December, 1977, he served two copies of the attached Reply Brief for Defendant-Appellant the attorney for the Plaintiff-Appellee herein by depositing the same, properly enclosed in a securely sealed post-paid wrapper, in a U. S. Post Office at 201 Varick Street, New York City, directed to said attorney at

Securities and
Exchange Comm.
500 N. Capital St.
Washington, D.C.

ATTN: Glynn L. Mays, Esq.

th i s being the place where they maintain an office for the regular transaction of business, and the last address mentioned in the papers last served by them.

Elliot Guzman

Sworn to before me this
29th day of December, 1977.

Monroe D. Rosen

MONROE D. ROSEN
Notary Public, State of New York
No. 24-4616690
Qualified in Kings County
Commission Expires March 30, 1979